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Supreme Court, U. S.
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In the

Supreme Court of the United States

October Term, 1935.

No. 252.

INTERNATIONAL STEEL AND IRON COMPANY,
Appellant,

vs.

NATIONAL SURETY COMPANY,
Appellee.

BRIEF ON BEHALF OF INTERNATIONAL STEEL AND IRON COMPANY, APPELLANT.

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BAIRD-WARD—NASHVILLE

SUBJECT INDEX.

PAGE

JURISDICTION 1

STATEMENT OF THE CASE 2
- Pleadings 2
- Decision of Chancery Court 4
- Decision of Court of Appeals of Tennessee 5
- Decision of Supreme Court of Tennessee 6
- Dissenting Opinion of Justice McKinney 8

SPECIFICATION OF ERROR 10

ARGUMENT 11
- Summary of Argument 12
  1. The surety bond required of a contractor under Chapter 74 of the 1917 Public Acts of Tennessee was a direct contractual obligation in favor of the furnisher of materials and labor 12
  2. The retention of ten per cent of the funds due the contractor pursuant to Chapter 74 of the 1917 Public Acts of Tennessee was a material part of the remedy under the statute and appellant contracted in reliance upon it 12
  3. Chapter 80 of the 1929 Public Acts of Tennessee released the obligation of the pre-existing surety contract, and diverted the retained funds, without the knowledge or consent of appellant, and, therefore, violated Section 10 of Article I of the Constitution of the United States 13
- The surety bond was a contractual obligation 13
- Substantive rights in retainage 17
- Discussion of legal questions 18

APPENDIX 24
- Chapter 74 of 1917 Public Acts of Tennessee 24
- Chapter 80 of 1929 Public Acts of Tennessee 26

TABLE OF CASES AND STATUTES CITED.

Cases.

PAGE

Cass v. Smith, 146 Tenn., 218 ..... 14, 15
City of Bristol v. Bostwick, 139 Tenn., 304 14
Equitable Surety Co. v. United States, 234 U. S., 448 ..... 14, 15, 16
Home Building & Loan Association v. Blaisdell, 290 U. S., 398 ..... 18, 19
Ogden v. Saunders, 12 Wheat., 213 18
Southern Construction Co. v. Halliburton, et al., 149 Tenn., 319 14
Standard Oil Co. v. Jamison Bros., 166 Tenn., 53 14
State of Louisiana v. Police Jury, etc., 111 U. S., 716 ... 21
Sturges v. Crowninshield, 4 Wheat., 197, 198 18
Worthen v. Kavanaugh, 295 U. S., 56 ..... 21, 22
Worthen v. Thomas, 292 U. S., 431, 432 21

Statutes.

Chapter No. 74 of 1917 Public Acts of Tennessee 2, 3, 6, 8, 10, 11, 12, 13, 14, 17, 18
Chapter No. 80 of 1929 Public Acts of Tennessee 5, 6, 7, 10, 12, 13, 17, 18

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BRIEF ON BEHALF OF INTERNATIONAL STEEL AND IRON COMPANY, APPELLANT.

May it Please the Court:

Jurisdiction.

Appellant has heretofore filed a separate statement as to jurisdiction, setting out the date of the judgment to be reviewed, the specific claims advanced, and rulings made in the lower court which are relied upon as the basis of this court's jurisdiction, a definite reference to the statutory provisions under which jurisdiction is invoked, and a reference to cases believed to sustain the jurisdiction, in compliance with Rule 12 of this court.

STATEMENT OF THE CASE.

Pleadings.

International Steel & Iron Company filed its original bill in the Chancery Court of Davidson County, Tennessee, on September 12, 1930, against National Construction Company, a contractor, National Surety Company (appellee) as surety on the contractor's bond, R. H. Baker, Commissioner of Highways and Public Works of the State of Tennessee (a formal party), and Equitable Casualty & Surety Company, as surety on the contractors refunding bond, seeking to recover a balance of $59,833.71 due appellant for labor and material furnished the contractor in the construction of a certain highway bridge at Perryville, Tennessee. (R., 13.)

The facts material to this appeal are set out in the original bill and are without dispute. On March 12, 1928, National Construction Company entered into a contract with the State of Tennessee, through its Department of Highways & Public Works, for the construction of a certain bridge across the Tennessee River known as the Perryville Bridge, and entered into a certain bond also dated March 12, 1928, on which bond appellee National Surety Company became surety. Under this bond National Construction Company as principal and National Surety Company as surety expressly guaranteed the payment on the part of the principal contractor for all materials, supplies and labor furnished and used in the construction of said bridge, said bond having been made pursuant to the then existing Statutes of the State of Tennessee (Section 6, Chapter 74 of the 1917 Public Acts of Tennessee), and being expressly for the benefit of such parties as furnished materials, supplies and labor to said contractor in the construction of said bridge. (R., 15.) The pertinent sections of this statute, as well as those of the subsequent statute known as Chapter 80 of the 1929 Public Acts of Tennessee, are set out in the appendix. The appellant seeks to hold

the appellee liable as surety on this bond, having entered into a contract with National Construction Company, the contractor, ten days thereafter to furnish certain labor and materials in the construction of the bridge.

National Construction Company filed an answer admitting the execution of the bond with National Surety Company as surety, but denied all indebtedness to the International Steel & Iron Company upon grounds which are not now material. (R., 27.) National Surety Company filed an answer admitting that it became surety on the bond on behalf of National Construction Company as principal, and that such bond was executed on March 12, 1928, and was conditioned as required by law in such cases. (R., 31.) In its answer National Surety Company further averred that it was informed that its principal denied the amount of the claimed indebtedness, and the answer further set out the fact that the Highway Commissioner had retained from the sums due the contractor an amount more than sufficient to pay the claim but had released these funds to the contractor upon its execution of a refunding bond with surety thereon, and that by reason of this latter transaction it had been released and relieved of all of its original liability as surety on the contractor's bond. (R., 32.)

The Supreme Court of Tennessee, in its opinion filed April 6, 1935, defined the obligation of the bond executed by National Surety Company as follows:

> "In March, 1928, the National Construction Company entered into a contract with the Highway Commissioner to build for the State a bridge over the Tennessee River at Perryville. As required by chapter 74 of the Acts of 1917, the Commissioner took a bond from the contractor with the National Surety Company as surety. This bond was conditioned, following the statute, 'upon the full and faithful performance of every part and stipulation of the contract, especially the payment for all materials purchased and for all labor employed in the contemplated work.'" (R., 1.)

R. H. Baker, the Highway Commissioner, and nominal defendant, filed an intervening petition reciting in substance that International Steel & Iron Company had duly filed its claim with the Department of Highways & Public Works for materials, supplies and labor furnished and used in the construction of the bridge and that sufficient cash funds had been retained from the amount due to National Construction Company, the contractor, with which to pay and satisfy the claim, but that all of these funds had been released and paid over to the contractor pursuant to a subsequent statute known as Chapter 80 of the Acts of 1929 upon the execution of a refunding bond by the National Construction Company as principal, and the defendant Equitable Casualty & Surety Company as surety, which bond was tendered into court. (R., 18-21.)

International Steel & Iron Company prayed the court for a judgment for the amount of its debt against National Construction Company upon its contract, National Surety Company as surety upon the contract, and Equitable Casualty & Surety Company as surety upon the refunding bond. (R., 17.)

Decision of the Chancery Court.

After the taking of proof and upon the hearing, the Chancellor rendered an opinion adjudging National Construction Company to be justly indebted to the International Steel & Iron Company in the sum of $58,593.71 for materials furnished and used in the construction of the bridge, and rendered judgment on said indebtedness against National Construction Company, and National Surety Company as surety on the bond. During the progress of the litigation Equitable Casualty & Surety Company had become insolvent and by consent decree (without prejudice) Consolidated Indemnity & Insurance Company had been substituted as surety on the refunding bond to the extent of $40,000.00. (R., 34-36.) Judgment was entered against this latter refunding surety for the amount of its bond and the

Chancellor directed that any amount recovered from the substitute surety on the refunding bond be credited upon the judgment rendered against the contractor and National Surety Company as surety on its contract. (R., 43-44.)

With respect to the defense of National Surety Company that it had been released by the payment of the retained funds to the contractor and the acceptance of a refunding bond, the Chancellor held:

> "The contractor's bond protects the claimants and was executed for their benefit as much as for the benefit of the State, and they cannot be deprived of that protection by the joint act of the principal thereon, and the obligee, the State, and this is true whether the refunding bond was taken within or without statutory authority. As to the surety, the National Surety Company, the contractor's bond is in law not to be treated as performed until complainant's claim is paid, its payment being a condition of the bond. This liability has not been discharged." (R., 38.)

No appeal was perfected by National Construction Company, the contractor, or Consolidated Indemnity & Insurance Company, the substituted surety on the refunding bond, and the decree became final with respect to these two parties. National Surety Company perfected an appeal to the Court of Appeals of Tennessee and assigned errors. (R., 45.)

Decision of the Court of Appeals of Tennessee.

The decision of the Court of Appeals of Tennessee, as set out in its opinion filed December 2, 1933, may be summarized as follows:

(a) The court first held that Chapter 80 of the 1929 Public Acts of Tennessee was not applicable to the present controversy because the contract and bond in question was executed on March 12, 1928, whereas the aforesaid Act

was not passed until a subsequent date in the year 1929, and was prospective only, and, therefore, would not be given a retroactive effect. The court held that the rights of the parties were to be determined under the provisions of Chapter 74 of the 1917 Public Acts of Tennessee, this being the applicable statute in effect at the time the contract was made. (R., 61.)

(b) The court further held that the action of the Highway Commissioner in releasing the retained funds to the contractor, and accepting the refunding bond, apparently upon the assumption that he was authorized so to do by Chapter 80 of the 1929 Public Acts of Tennessee, was wholly unauthorized, and that this unauthorized act of the Highway Commissioner, done without the consent of National Surety Company as surety on the contractor's bond, had the legal effect of releasing the surety from further liability. (R., 67.)

The Court of Appeals of Tennessee therefore reversed the holding of the Chancellor and dismissed complainant's action against National Surety Company. (R., 68.)

Decision of the Supreme Court of Tennessee.

International Steel & Iron Company and National Surety Company both applied to the Supreme Court of Tennessee for the writ of *certiorari*, which was granted on both applications, and both parties assigned error to the foregoing action of the Court of Appeals of Tennessee. (R., 68-69.)

In the Supreme Court of Tennessee the National Surety Company contended that Chapter 80 of the 1929 Public Acts of Tennessee, enacted subsequently to the execution of the surety bond, was applicable and that the Court of Appeals erred in holding to the contrary, the Surety Company contending that the Highway Commissioner acted rightfully in releasing the retained funds and taking the refunding bond, and that the legal effect of such action was to satisfy and release the obligation of its surety bond.

(R., 68.) International Steel & Iron Company contended that Chapter 80 of the 1929 Public Acts of Tennessee was not applicable to the controversy for the reasons stated by the Court of Appeals, but assigned as error the action of the court in holding that National Surety Company had been released by the foregoing action of the Commissioner of Highways & Public Works. (R., 69.)

The Supreme Court of Tennessee by a majority opinion affirmed the decision of the Court of Appeals of Tennessee but upon *wholly different grounds*, and upon a contrary line of reasoning. The holding of the Supreme Court of Tennessee may be summarized as follows:

(a) The court held that Chapter 80 of the 1929 Public Acts of Tennessee was applicable to the controversy even though it was not passed until after the contract had been made, and construed said Act from its language and purpose to be retroactive. The court, therefore, held that the Highway Commissioner acted properly and pursuant to the applicable statute in paying over the retained funds to the contractor upon the execution of the refunding bond. (R., 5-6.) We quote from the opinion:

> "We construe the statute as regulating, after its passage, the procedure to be followed by all parties in respect to the final settlement of every highway contract, whether the contract itself was made before or after the enactment of Chapter 80 of the Acts of 1929." (R., 5.)

(b) The court held that under the provisions of Chapter 80 of the 1929 Public Acts of Tennessee the intent and effect of the release of the retainage by the Highway Commissioner upon the execution of a refunding bond was to release and discharge the contractual obligation of the National Surety Company as surety on the contractor's bond. The court said:

> "It must have been contemplated that the release of the retainage by the Highway Commissioner, either

> under (a) or under (b)—the retainage being adequate to cover litigated claims—would discharge the surety on the contract bond from liability to laborers and materialmen. Otherwise the validity of (a) and (b) could scarcely be sustained. . . . The surety's rights with respect to the retainage, being contract rights, could not be taken away unless adequate security was substituted for the retainage and the Act of 1929 offers no such substitute to the contract surety." (R., 4.)

The Court held that the rights of appellant as a furnisher of materials under Chapter 74 of the 1917 Public Acts of Tennessee against the retained funds and the surety on the contractor's bond was in the nature of a remedy, and that the subsequent Acts of 1929 substituted for the original liability of the surety and in lieu of the retainage an indemnity or refunding bond which ordinarily would be as good protection as the contractual obligation of the original surety, and the claim against the retained funds. The court concluded, therefore, that the release of the obligation of the National Surety Company's contract without the consent of appellant, pursuant to a statute passed after the contract had been made, affected only the remedy and, therefore, violated no constitutional rights. The court summarized its holding as follows:

> "By the Act of 1917 complainant Steel Company was given recourse on the retainage and on the contract bond to secure its rights arising under its engagement with the general contractor. For these remedies the Act of 1929 substituted recourse on an indemnity or refunding bond. . . . The protection offered by one bond would ordinarily be as good as the protection offered by the other. As a rule, bonds from surety companies are taken." (R., 7-8.)

Dissenting Opinion of Justice McKinney.

Justice McKinney filed a dissenting opinion, pointing out that the decision of the majority of the court had the effect

of impairing and destroying the obligation of a pre-existing contract by subsequent legislation, and, therefore, rendered the legislation unconstitutional. We quote from the dissenting opinion of Justice McKinney as follows:

> "I concur with the Chancellor and the Court of Appeals in holding that the Act of 1929 should be construed as prospective, otherwise it would be unconstitutional as impairing the obligation of a contract. Upon the strength of the bond executed by the National Surety Company complainant furnished steel of the value of $135,000. Under the majority opinion the legislature can destroy this obligation by authorizing the Commissioner of Highways to substitute other security, which, as in this cause, was worthless, and upon which complainant might not have been willing to furnish this large quantity of material. This, in my opinion, extends the rule of remedies further than is justified under elemental principles of contract. The National Surety Company, for a paid consideration, said to complainant if you will furnish this material we will guarantee that you will receive your money. Upon this agreement the Surety Company now says that it is released because, without the knowledge or consent of complainant, another agency substituted other surety in its stead. Treating the Act of 1929 as prospective, it is valid, and those who contract subsequent to its enactment would be bound by its provisions. But to give it a retrospective application certainly causes complainant to lose a large sum of money which the National Surety Company guaranteed the payment of." (R., 8-9.)

Pursuant to the majority opinion a decree was entered dismissing the action of the International Steel & Iron Company and releasing National Surety Company from all liability. (R., 9.) From this decree and from the action of the Supreme Court of Tennessee this appeal has been prayed and duly perfected. (R., 9-10.)

SPECIFICATION OF ERROR.

Chapter 80 of the 1929 Public Acts of Tennessee, as construed and applied by the Supreme Court of Tennessee in this cause, is invalid and violates Section 10, Article 1, of the Constitution of the United States in that:

(a) The rights and remedies of International Steel & Iron Company against National Surety Company as surety on the contractor's bond, and its right in and to the retained funds, became fixed at the time the contract was entered into on March 22, 1928, and was governed by the then existing statute, to-wit, Chapter 74 of the 1917 Public Acts of Tennessee, under the provisions of which the National Surety Company became obligated by its contract of suretyship to pay appellant's indebtedness in the event of default by the contractor, and further under the provisions of which funds of the contractor were required to be retained by the Highway Commissioner and paid into court for the purpose of satisfying the amount due appellant. Chapter 80 of the 1929 Public Acts, passed subsequently, as construed by the Supreme Court of Tennessee, undertook to impair, release and destroy the means provided pursuant to Chapter 74 of the Public Acts of 1917 for the enforcement of appellant's contract, and hence violated Section 10, Article 1, of the Constitution of the United States.

(b) Under the provisions of Chapter 74 of the 1917 Public Acts of Tennessee, in effect at the time the contract was entered into, National Surety Company entered into a contractual obligation, under the terms of which it guaranteed the payment of the indebtedness of International Steel & Iron Company upon default by the contractor, and Chapter 80 of the 1929 Public Acts of Tennessee impaired, released and discharged the solemn obligation of this contract without the knowledge or consent of International Steel & Iron Company, and hence is violative of Section 10, Article 1, of the Constitution of the United States. (R., 11.)

ARGUMENT.

The only applicable statute in Tennessee at the time the contract was entered into on March 22, 1928, was Chapter 74 of the 1917 Public Acts of Tennessee. Ten days prior to the making of the contract to furnish the materials the contractor made an indemnity bond with National Surety Company as contract surety thereon for a paid consideration as required by Section 6 of said Chapter 74 of the 1917 Public Acts of Tennessee. The *obligation* which the contractor and its surety were required to enter into by this statute was conditioned for the faithful performance of every part of the contract, "*especially the payment for all materials purchased, and for all labor employed in the contemplated work.*" (R., 1.) International Steel & Iron Company entered into its contract in express reliance upon the solvency and financial ability of National Surety Company to pay its indebtedness in the event of default by the contractor. National Surety Company, therefore, became bound by the obligation of its contract to pay any indebtedness that might become due to International Steel & Iron Company from the contractor if the debt was not discharged by the contractor. Although the bond was required by a statute, the obligation was that of a contract liability, voluntarily assumed.

Under the further provisions of Chapter 74 of 1917 Public Acts, the Highway Commissioner was required to retain ten per cent of the funds due the contractor, with which to satisfy just claims, and upon the institution of suit by a furnisher of materials these funds were required to be paid into court, the only condition being that such suit should be brought within a reasonable time.

It results therefore that at the time the contract was entered into, under the applicable statute the International Steel & Iron Company acquired (a), the contractual obligation of National Surety Company to pay for all materials furnished in the event of default by the contractor,

and (b) a fixed right to a retainage equal to ten per cent of the amount due the contractor, to be held by the Highway Commissioner for its benefit.

Chapter 80 of the 1929 Public Acts of Tennessee was passed by the General Assembly of Tennessee on April 10, 1929, and became effective on April 11, 1929, when it was approved by the Governor. This was more than twelve months after the contractual rights and obligations of the parties had become fixed under the prior statute. This latter enactment, as construed by the Supreme Court of Tennessee in the present case, was retroactive by its terms, and had the effect of permitting the Highway Commissioner to release the retained funds previously held for appellant's benefit, and also by the same act, to discharge and release the contractual obligation of National Surety Company as surety on the original contract, and all of this without the knowledge or consent of the International Steel & Iron Company.

The argument of appellant upon the unconstitutionality of Chapter 80 of the 1929 Public Acts of Tennessee, as thus construed and applied, may be summarized in the following propositions:

Summary of Argument.

1. The surety executing the contractor's bond, pursuant to the applicable statutes in existence at the time the contract was made (Chapter 74 of the 1917 Public Acts of Tennessee), became directly obligated by its contract to pay and discharge the debt due appellant upon default of the surety's principal. The obligation to enter into the bond was statutory; *the bond when entered into pursuant to the statute created a voluntary contractual obligation between the parties.*

2. The statute in effect at the time the contract was made (Chapter 74 of the 1917 Public Acts of Tennessee) further created a retained fund of ten per cent of the amount due

the contractor, to be held by the Highway Commissioner as a guaranty fund with which to pay and discharge any obligation due to the appellant as a furnisher of materials. Appellant acquired a substantive right to have such funds retained, the contract having been made in express reliance upon the statute, and the retention of such funds constituted a material part of appellant's remedy under the statute.

3. When the Supreme Court of Tennessee in the present case construed the subsequent statute (Chapter 80 of the 1929 Public Acts of Tennessee) as retroactive by its terms, and applicable to pre-existing contracts, and further construed said Act as authorizing and permitting the release and discharge of the contractual obligation of the surety on the contractor's bond, and as further permitting the diversion of the retained funds held by the Commissioner of Highways under the previous statute, and further held that such could be accomplished without the knowledge or consent of appellant, the effect of the latter statute was to both destroy and impair the obligation of the surety's contract in favor of appellant and to deprive it of a substantial remedy in and to the retained funds, amounting to both a destruction of the contract and a denial of the means of its enforcement in violation of Section 10, of Article 1, of the Constitution of the United States.

I.

The Surety Bond Was a Contractual Obligation.

There can be no question but that the execution of the surety bond by the National Surety Company on March 12, 1928, created a direct contractual obligation between it and the subsequent furnishers of material upon the public work embraced within the contract.

Chapter 74 of the 1917 Public Acts of Tennessee, and other similar statutes have been so construed by the Su-

preme Court of Tennessee and by this Court in numerous cases.

City of Bristol v. *Bostwick,* 139 Tenn., 304.
Cass v. *Smith,* 146 Tenn., 218.
Southern Construction Co. v. *Halliburton, et al,* 149 Tenn., 319.
Standard Oil Co. v. *Jamison Bros.,* 166 Tenn., 53.
Equitable Surety Co. v. *United States,* 234 U. S., 448.

The Supreme Court of Tennessee has construed Chapter 74 of the 1917 Public Acts of Tennessee as being designed primarily for the protection of the furnishers of material on public works.

> "The laborer and materialman are objects of special protection in matters such as the one before us. Such a policy of our law is plain in the statute."
> *Southern Construction Co.* v. *Halliburton,* 149 Tenn., pp. 337, 338.

Construing a similar statute the court said:

> "Under Chapter 182 of the Acts of 1899, upon giving proper notice of their claims, laborers and materialmen might have themselves sued on such a bond, or the High School Board might have sued in the outset for the benefit of such laborers or materialmen."
> *Cass* v. *Smith,* 146 Tenn., p. 227.

The contractual obligation of such a bond was expressly recognized by the Supreme Court of Tennessee in the following language:

> "We think the bond is dual in its nature, as recognized in some of our cases (*Cass* v. *Smith,* 146 Tenn., 225, and *City of Bristol* v. *Bostwick,* 139 Tenn., 304), and the action thereon by the Oil Company may be sustained in either aspect."
> *Standard Oil Co.* v. *Jamison Bros.,* 166 Tenn., pp. 55, 56.

In the case of *Cass* v. *Smith*, 146 Tenn., at pages 227-228, the Supreme Court of Tennessee, construing a similar statute, quoted with approval from a decision of the Supreme Court of the United States in *Equitable Surety Co.* v. *United States*, 234 U. S., 448. In the latter case this court specifically held that a similar surety bond executed pursuant to an analogous Federal Statute created a contractual obligation in favor of the furnisher of material which could not be bartered away without the consent of the beneficiaries. We quote from the opinion of Mr. Justice Pitney as follows:

> "In *United States Fidelity & G. Co.* v. *Golden Pressed & Fire Brick Co.* (*United States Fidelity & G. Co.* v. *United States*), 191 U. S., 416, 48 L. Ed., 242, 24 Sup. Ct. Rep., 142; and *United States use of Hill* v. *American Surety Co.*, 200 U. S., 197, 203, 50 L. Ed., 437, 440, 26 Sup. Ct. Rep., 168, this court adopted a reasonably liberal construction of the Act of 1894, in view of the fact that it was evidently designed to furnish the obligation of a bond as a substitute for the security which might otherwise be obtained by attaching a lien to the property; such lien not being permissible in the case of a government work. . . .
>
> ". . . The object of the legislation was to give legal sanction to the 'additional obligation that such contractor or contractors shall promptly make payments to all persons supplying him or them labor and materials in the prosecution of the work provided for in such contract,' and to give to such a laborer or materialman the right to bring an action, if necessary, upon the bond, either in the name of the District of Columbia or of the United States, for his own benefit, against the contractor and sureties. The nominal obligee is, with respect to these third parties, a mere trustee, and the obligors, including the surety as well as the principal contractor, enter into the obligation in full view of this. The public is concerned not merely because laborers and materialmen (being without the benefit of a mechanics' lien in the case of public buildings) would otherwise be subject to great losses at the hands of

> insolvent or dishonest contractors, but also because the security afforded by the bond has a substantial tendency to lower the prices at which labor and material will be furnished, because of the assurance that the claims will be paid."
>
> *Equitable Surety Co.* v. *United States,* 234 U. S., pp. 455, 456.

Thus a contractual obligation existed in favor of International Steel & Iron Company from the moment it entered into the contract to furnish the steel to the principal contractor. Under this contract National Surety Company obligated itself voluntarily as surety and guaranteed the payment of the indebtedness to accrue in the event of default by the principal contractor. The obligation of this contract is apparently recognized by the majority opinion of the Supreme Court of Tennessee in the present case in the following language:

> "These bonds taken by governmental agencies are dual in nature. They undertake to secure to the obligee the faithful performance of the public work and also, by statutory requirement, undertake to secure to the laborers and materialmen payment of their claims against the contractor." (R., 3-4.)

The majority opinion, however, held that the statute, in requiring the surety bond, was undertaking to afford the materialman a "remedy." The Court thereupon proceeded to deal with the surety's contractual obligation upon the theory that it being a mere "remedy" (as distinguished from a "right"), it could be altered or discharged by subsequent legislation if another substantial remedy were provided in its place. The holding of the majority of the justices was equivalent to saying that if the obligation of a contract was provided as a remedy required by statute, such contractual obligation was not within the protection of Section 10, Article 1, of the Constitution of the United States.

The fundamental error of the Court is apparent: The Legislature may provide such remedies as it deems advisable

for a materialman in lieu of the ordinary lien which does not obtain upon public works. If this remedy consists of a contractual obligation voluntarily entered into by a surety, the Legislature could not thereafter impair or destroy such an obligation by a retroactive statute without violating the section of the Federal Constitution above referred to. The obligation of a contract, after it is entered into, is protected by the Constitution, irrespective of whether it was entered into *pursuant to a statute, or in the absence of a statute.* Such was the basis of the dissenting opinion of Mr. Justice McKinney. (R., 8-9.)

It being conceded by all parties that the effect of the subsequent enactment, Chapter 80 of the 1929 Public Acts of Tennessee, was to release and discharge the contractual obligation of the National Surety Company as surety without the consent of the obligee it is submitted that the subsequent enactment violates the applicable provisions of the Constitution of the United States and is, therefore, void. This being true, the Supreme Court of Tennessee should have rendered the judgment in favor of International Steel & Iron Company against National Surety Company and its surety on the appeal bond in this case, for the amount of the debt, to wit $58,593.71.

II.

Substantive Rights in Retainage.

Chapter 74 of the 1917 Public Acts of Tennessee afforded appellant a further substantive right by requiring the Highway Commissioner to retain ten per cent of the sums due the contractor as a guarantee fund for the payment of the contractor's indebtedness for material and labor. Upon the filing of proper claim by materialmen and failure of the contractor to pay, the Highway Commissioner became a mere stakeholder of this fund and was prohibited by the statute from turning it over to the contractor and was required to pay the funds into court to satisfy the materialman's claim if suit was brought within a reasonable time.

In the present case, at the conclusion of the work, the Highway Commissioner had retained more than sufficient funds to satisfy the claim of International Steel & Iron Company. The Commissioner had no interest in the funds, being merely a stakeholder, enjoined with the duty (under Chapter 74 of the 1917 Public Acts of Tennessee) of holding these funds and paying them into court for the materialman's benefit. He was not permitted under any circumstances to deliver these funds to the contractor until after the materialman had waived its right by failure to sue within a reasonable time. He could not take a refunding bond, nor could he destroy the materialman's rights to have these funds subjected to the payment of his claim.

The majority opinion of the Supreme Court of Tennessee in the instant case has held that all of these rights were changed and taken away by the subsequent enactment of Chapter 80 of the 1929 Public Acts of Tennessee. That court held that the Highway Commissioner, although a mere stakeholder, having no interest in the funds, might pay them over to the contractor upon the execution of a refunding bond, and that such refunding bond might be taken without the knowledge or consent of the furnisher of materials. This effectively destroyed and impaired a fund created for the sole benefit of the furnisher of materials, which was mandatory under the law in existence at the time International Steel & Iron Company entered into its contract in this cause.

III.

Discussion of Legal Questions.

It is elementary that the obligations of a contract are impaired by a law which releases or extinguishes such obligation.

Sturges v. *Crowninshield,* 4 Wheat., pp. 197, 198.
Ogden v. *Saunders,* 12 Wheat., 213.
Home Building & Loan Assn. v. *Blaisdell,* 290 U. S., 398.

In *Home Building & Loan Association* v. *Blaisdell,* 290 U. S., p. 398, this court said:

> "The obligation of a contract is 'the law which binds the parties to perform their agreement.' *Sturges* v. *Crowninshield,* 4 Wheat., 122, 194, 4 L. Ed., 529, 549. 549 Story. op. cit., Sec. 1378. This Court has said that 'the laws which subsist at the time and place of the making of a contract, and where it is to be performed, enter into and form a part of it, as if they were expressly referred to or incorporated in its terms. This principle embraces alike those which effect its validity, construction, discharge and enforcement. . . . Nothing can be more material to the obligation than the means of enforcement. . . . The ideas of validity and remedy are inseparable and both are parts of the obligation, which is guaranteed by the Constitution against invasion.' *Von Hoffman* v. *Quincy,* 4 Wall., 535, 550, 552, 18 L. Ed., 403, 408, 409. See also *Walker* v. *Whitehead,* 16 Wall., 314, 317, 21 L. Ed., 357, 358. . . .
>
> "The obligations of a contract are impaired by a law which renders them invalid, or releases or extinguishes them. (*Sturges* v. *Crowninshield, supra* (4 Wheat., pp. 197, 198, 4 L. Ed., 549)), and impairment, as above noted, has been predicated of laws which without destroying contracts derogate from substantial contractual rights."
>
> *Home Building & Loan Association* v. *Blaisdell,* 290 U. S., p. 398.

Any statute passed after National Surety Company had entered into its contractual obligation for the benefit of International Steel & Iron Company, which had the effect of releasing or extinguishing the right of International Steel & Iron Company to sue and enforce payment upon the contractual obligation, was an impairment of the obligation of the contract, and Chapter 80 of the 1929 Public Acts of Tennessee having been expressly given such a construction by the Supreme Court of Tennessee, it must be struck down

as a violation of the constitutional rights of International Steel & Iron Company.

It is said in reply to the foregoing argument that the contractual obligation of the surety and the right in the retained funds provided pursuant to Chapter 74 of the 1917 Public Acts of Tennessee, were not, properly speaking, *rights* at all but were *remedies* afforded the materialman by the statute to enable it to enforce its rights arising under the agreement with the general contractor. (R., 4-5.) It is then argued that the legislature might properly alter this remedy without impairing a constitutional right provided it substituted another remedy which ordinarily would afford adequate protection. Upon this hypothesis the majority of the Supreme Court of Tennessee concluded that Chapter 80 of the 1929 Public Acts provided a new contractual obligation against the refunding surety to take the place of the preexisting contractual obligation against the contract surety which had been released by the statute. It is said that ordinarily one surety is as good as another, though the opinion expressly recognizes the possibility of insolvency of one or both of such sureties. (R., 8.) The effect of such an argument is to say that the legislature may destroy the obligation of a contract if it provides a substitute contractual obligation assumed by a stranger to the original contract, and that this can be accomplished against the will and without the consent of the beneficiary of the original contract. It would be the same thing to say that the legislature may release the surety on a promisory note provided it within its wisdom substituted some one else in the place of the original surety, upon the theory that a contractual surety who guarantees the payment of an obligation merely affords a "remedy," and that ordinarily one surety would be considered as financially responsible as any other surety. We submit that such an argument is unsound. If the right to sue a surety on a contractual obligation be considered a remedy, it is a remedy which cannot be impaired and which is protected by the Constitution of the United States. To release the obligation or extinguish it by a subsequent

statute is a violation of constitutional rights which is not cured or prevented by the attempted substitution of another contractual obligation.

Furthermore, it must be remembered that even if Chapter 80 of the 1929 Public Acts of Tennessee be construed as effecting only a remedy, it is clear that it impaired and destroyed the right of the materialman to the retained fund held by the Highway Commissioner as a stakeholder (which in the present case exceeded the amount of the indebtedness) and impaired and destroyed its right to have these funds applied to the satisfaction of its indebtedness, and substituted in lieu thereof merely a right to sue a new surety on a refunding bond, selected without its knowledge or consent. Looking at the situation from the standpoint of a remedy only, Chapter 80 of the 1929 Public Acts destroyed a substantial remedy which was held by the International Steel & Iron Company, and substituted a chose in action of doubtful value in its place. The obligation of a contract includes its means of enforcement and the substantive rights created thereby in and to funds or property held by stakeholders to guarantee such enforcement.

State of Louisiana v. *Police, Jury, etc.*, 111 U. S., 716.
Worthen v. *Thomas*, 292 U. S., pp. 431, 432.
Worthen v. *Kavanaugh*, 295 U. S., 56.

"Whether such repeal was effectual to deprive him of the process prayed, depended upon the question whether the judgment was founded upon a contract, the obligation of which the State is prohibited from impairing. *By the obligation of a contract is meant the means which at the time of its creation, the law affords for its enforcement.*"

State of Louisiana v. *Police Jury, etc.*, 111 U. S., 716, 28 L. E., 574.

"To know the obligation of a contract we look to the laws in force at its making. *Sturges* v. *Crowninshield*, 4 Wheat., 122, 197, 4 L. Ed., 529, 549; *Home Bldg. & Loan Association* v. *Blaisdell*, 290 U. S., 398, 429, 78 L. Ed., 413, 423, 54 S. Ct., 231, 88 A. L. R.,

1481. In the books there is much talk about distinctions between changes of the substance of the contract and changes of the remedy. *Von Hoffman* v. *Quincy*, 4 Wall., 535, 18 L. Ed., 403; *Louisiana* v. *New Orleans*, 102 U. S., 203, 26 L. Ed., 132; *Barnitz* v. *Beverly*, 163 U. S., 118, 41 L. Ed., 93, 16 S. Ct., 1042; cf. *Home Building & Loan Association* v. *Blaisdell, supra* (290 U. S., 429, 434, 78 L. Ed., 423, 426, 54 S. Ct., 231, 88 A. L. R., 1481), where the cases are assembled. The dividing line is at times obscure. There is no need for the purposes of this case to plot it on the legal map. Not even changes of the remedy may be pressed so far as to cut down the security of a mortgage without moderation or reason or in a spirit of oppression. Even when the public welfare is invoked as an excuse, these bounds must be respected. *W. B. Worthen Co.* v. *Thomas*, 292 U. S., 426, 433, 78 L. Ed., 1344, 1346, 54 S. Ct., 816, 93 A. L. R., 173, distinguishing *Home Building & Loan Association* v. *Blaisdell*, 290 U. S., 398, 78 L. Ed., 413, 54 S. Ct., 231, 88 A. L. R., 1481, *supra*. We state the outermost limits only. In stating them we do not exclude the possibility that the bounds are even narrower. The case does not call for definition more precise."

Worthen v. *Kavanaugh*, 295 U. S., 56.

A statute which proposes to release the solemn obligation of a pre-existing contract upon the strength of which the appellant furnished its materials, and at the same time discharges and destroys appellant's rights in and to a trust fund retained by the Highway Commissioner as a mere stakeholder for the sole benefit of this furnisher of materials, and seeks to substitute in lieu thereof the obligation of a surety on a refunding bond without giving the materialman a right to pass upon the solvency of the new surety,—and in fact without its knowledge or consent—is most certainly a statute which takes away substantive rights and remedies, and is so oppressive as to violate the protective provisions contained in the Federal Constitution.

We, therefore, respectfully submit that Chapter 80 of the 1929 Public Acts of Tennessee, as construed by the majority opinion of the Supreme Court of Tennessee in the present case, must be held to be violative of Section 10, Article I, of the Constitution of the United States, and, therefore, void and of no effect, and that the decree of the Supreme Court of Tennessee should be reversed, and that judgment should be rendered in favor of appellant against National Surety Company, and likewise against its surety on the appeal bond in the state courts for the sum of $58,593.71 and that such judgment should be entered in this court in accordance with the applicable federal statute, or the cause should be remanded to the Supreme Court of Tennessee for such purpose.

Respectfully submitted,

ISIDOR KAHN,
LOUIS LEFTWICH,
CECIL SIMS,
Counsel for Appellant.

F. M. BASS,
Of Counsel.

APPENDIX.

CHAPTER NO. 74, 1917 PUBLIC ACTS OF TENNESSEE.

SENATE BILL No. 232.

(By Messrs. Matthews, Johnson, Creswell, Haston, Nichols, Jarvis.)

AN ACT to provide revenue for use in road building in this State by the State Highway Department, acting in conjunction with the Secretary of Agriculture of the United States and in conformity to an Act of the Sixty-fourth Congress approved July 11, 1916, entitled, "An Act to provide that the United States shall aid the States in the construction of rural Post Roads, and for other purposes;" to provide for the expenditure of all funds raised by the State of Tennessee to supplement said Federal appropriation and other funds raised under this Act; to confer upon the State Highway Department certain powers with respect to the distribution and expenditure of said entire fund, and to impose certain duties and place certain restrictions upon said State Highway Department with respect thereto and to provide the means and instrumentalities for laying out and carrying on the work of road building in this State, as contemplated by said Federal statute; and to penalize violations of this Act.

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SEC. 6. *Be it further enacted,* . . . . . .

. . . . . All contractors with whom contracts are made by the Department shall enter into good and solvent surety bond in an amount fixed by the Department, conditioned upon the full and faithful performance of every part and stipulation of the contract, especially the payment

for all materials purchased and for all labor employed in the contemplated work. This bond must be approved by the Department and filed with its records. The contract shall provide that the work executed thereunder shall be subject to the inspection, approval, and acceptance of the State Highway Engineer or his assistant engineer acting on oath and under bond. Not more than ninety per cent of the contract price shall be paid on any contract until it is completed and the work is accepted. Before final acceptance, the contractor must furnish evidence to satisfy the Department that all the material used by him, his subcontractors, or his agents, have been fully paid. When this is done, full settlement may be made with the contractor; but not until thirty days' notice in some newspaper published in the county where the work is done, if there be a newspaper published there, and if not, in a newspaper in an adjoining county, that settlement is about to be made and notify all claimants to file notice of their claim with the Secretary of the Department. The Secretary of the Department shall withhold a sufficient sum from the contract price due to pay all claims, including advertising, of which notice is filed with him, for a reasonable time to allow claimants to sue for and prove their claims against the contractor or his agent, in some court of competent jurisdiction.

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Passed March 30, 1917.

W. R. CRABTREE,
Speaker of the Senate.

CLYDE SHROPSHIRE,
Speaker of the House of Representatives.

Approved April 3, 1917.

TOM C. RYE,
Governor.

CHAPTER NO. 80, 1929 PUBLIC ACTS OF TENNESSEE.

SENATE BILL No. 510.
(By Messrs. Pratt, Adams and Gray.)

AN ACT to amend Chapter 74 of the Public Acts of the year 1917, passed March 30, 1917, approved April 3, 1917, the caption of which is as follows:

"An Act to provide revenue for use in road building in this State by the State Highway Department, acting in conjunction with the Secretary of Agriculture of the United States and in conformity to an Act of the sixty-fourth congress approved July 11, 1916, entitled, 'An Act to provide that the United States shall aid the states in the construction of rural post roads, and for other purposes'; to provide for the expenditure of all funds raised by the State of Tennessee to supplement said federal appropriation and other funds raised under this Act; to confer upon the State Highway Department certain powers with respect to the distribution and expenditure of said entire fund, and to impose certain duties and place certain restrictions upon said State Highway Department with respect thereto and to provide the means and instrumentalities for laying out and carrying on the work of road building in this State, as contemplated by said Federal Statute; and to penalize violations of this Act."

SECTION 1. *Be it enacted by the General Assembly of the State of Tennessee,* That Chapter 74 of the Public Acts of 1917, be and the same is hereby amended as follows:

. . . . . .

(a) "The Secretary of the Department (now the Commissioner of Highways and Public Works) shall withhold a sufficient sum from the contract price due to pay all claims, of which notice is filed with him, for a period of sixty days from the date of the last advertis-

ing, to allow claimants to sue and prove their claims against the contractor or his agent, in some court of competent jurisdiction. In the event suit is brought against the contractor within the said sixty days from the date of the last advertising, by any claimant, the Department or its officer shall pay the amount of said claim into court. But in all cases where suits are not brought within the said period of sixty days the Secretary shall pay said sum or sums so withheld to the contractor.

(b) "On the date set for full and final settlement with the contractor, the contractor may make proper refunding bond to the State of Tennessee for the amount of any sum or sums so held for the said period of sixty days, such bond to be approved by the Commission, whereupon the Commissioner or the Department of Highways and Public Works shall pay such contractor in full.

(c) "All suits against contractors brought by any claimant shall make the Commissioner of Highways and Public Works a defendant thereto and, except where the same be for sums within the jurisdiction of a Justice of the Peace, shall be brought in the county where the main office of the Department of Highways and Public Works is situated. On any such suit being brought the sums then withheld may be paid into court, as above provided, by simple petition of the Commissioner which may be substantially as follows:

" 'Your petitioner, the Commissioner of Highways and Public Works, respectfully represents that under Chapter 74 of the Public Acts of 1917, and acts amendatory thereof, he has retained from (here insert name of contractor) on final estimate or settlement, $....., equal in amount to the claim of (here insert name of claimant), as the same was filed and presented to the Department of Highways and Public Works, a copy or photostatic copy of which is hereto attached, and, therefore, as authorized by law

to do, suit having been brought by the claimant, your petitioner pays said sum to the Clerk of the court, by voucher or warrant No..... dated ....., payable to the order of said Clerk for $....., drawn against the funds of said Department of Highways and Public Works, accompanying this petition, and your petitioner prays that the cause be dismissed as to him, this payment being in the nature of and for the purpose of an interpleader.'

"Such petition shall be signed by the Commissioner or the attorney for the Department of Highways and Public Works for him, and upon the filing of such petition accompanied by such payment the suit shall be dismissed as to the Commissioner as a matter of right, such sum so paid into court, as to the plaintiff or claimant, standing in lieu and as a satisfaction of the contractor's bond and a fulfillment of the duties of the Department of Highways and Public Works to the claimant or plaintiff."

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Passed April 10, 1929.

S. R. BRATTON,
Speaker of the Senate.

CHAS. H. LOVE,
Speaker of the House of Representatives.

Approved April 11, 1929.

HENRY H. HORTON,
Governor.